

Will Foreign Investors Come After The Restrictions Are Lifted?

The restrictions implemented to fight with Covid-19 and its virus are slowly being eased. There will be many changes we will need to adopt to in this new world waiting for us. I want to discuss here the return of foreign investment to Turkey, because I believe some of the economic policy decisions taken to prepare for and soften the effects of the approaching economic crises may delay the return of foreign investors to Turkey.

Amendments to the legislation and its implementation

Let's take a look at some of the new legislation and practices in banking and finance since the beginning of April that would be more interest to foreign investors.

On April 13th, the Ministry of Treasury and Finance (the "Ministry") sent a letter to the banks. The letter said that a "risk" was observed in terms of "money laundring/war against terror" during the fight against the Covid-19 virus. The basis for such risk was not mentioned in the letter, but the banks were required to notify the Ministry before making any money transfers from Turkey of TL100k or above (or its equivalent in any other currency. This leads the foreign investors to consider one of the scenarios they dislike the most in jurisdictions they invest, "do I need to worry about some sort of a capital control?".

On April 18th, the concept of "asset ratio" was included in the banking legislation. For the Turkish private banking sector, a big chunk of which is controlled by foreign financial institutions, this in practice means that they will have to use their liquidity preferably by lending to the real sector borrowers, or invest in government bonds or enter into swaps with the Central Bank. This was not a suggestion, it is a requirement which if not complied with and the ratio is not met, will be penalized with heavy fines.

Last week was very eventful. Quoting from a banker friend "this looks like an intervention by the banking regulator to the increasing usd/tl fx rate after the Central Bank stopped trying to suppress the usd/tl fx rate", referring to the Regulation on Manipulation and Misleading Transactions in the Financial Markets (the "Manipulation Regulation") issued on May 7th. This legislation with its vague language and potential to affect many transactions added to the concerns of the foreign investors.

On top of these, Citi, BNP and UBS were first restricted to engage in TL transactions, and then this was overturned, but in between many banks could not close at the end of the day due to this restriction, first time since the 2001 crisis.

Effects of the decisions on the markets and reaction from foreign investors

Economic policy decisions are certainly not required to be liked by foreign investors, what I am more concerned about is the unintended consequences these may create.

Citi and BNP work as the "custodian bank" for a vast majority of foreign investors in Turkey. The TL transaction restriction imposed on them and the resulting settlement problems will create a reputational risk on the Turkey operations of these banks, and this may in itself negatively affect the investment decisions of foreign investors.

Asset ratio regulation may be interpreted by many foreign investors as "the Turkish private banking sector will need to make its credit and investment decisions based not on market conditions but on economic policy".

Manipulation Regulation already started affecting the markets, as far as I know it is not even possible now to make an fx transaction with a Turkey as the counter party in some foreign financial centers.

CDS premium of Turkey is now 590 bps. It is 265 for Greece and 145 for Russia. Is our economy worse than Greece? Surely not. Is "rule of law" more established in Russia compared to us? No it is not. The investors see other risks in the Turkish market now. That is why our CDS premium, which was lower than Russia 3 years ago, is now almost 4 times it.

This of course did not happen because of Covid-19 or the quarantine or the related actions taken, there is a history, however, the legislation discussed above and enacted or implemented during Covid-19 and the related restrictions, have the potential to result in unintended consequences similar to the past legislation and practices.

What does foreign investor want?

Foreign investors want rule of law, they need a legal system they can trust. Imposing economic policy decisions at the risk of endangering free market rules, the current concerns on the freedom of the judiciary, there are many issues which can be discussed under this topic. I will give only one example. The concept of "President Degree" was included in our legislation following the amendments to the Constitution in 2018. The President decides whether a President Degree will be published in the Official Gazette. As of end of March 2020, around 2400 President Degrees were issued and it is not possible to know how many of them were published in the Official Gazette. This means: There may be hundreds of such degrees and related legislation which would potentially affect the investment decisions of foreign investors had they been published. and I, as their legal advisor, do not have the opportunity to know, or find out about, these

Foreign investors want consistency in law, legislation and their application. Examples of conflicting actions and inconsistency in the economic policy decisions such as the quick back pedalling from the TL transaction restriction imposed on the 3 foreign banks on May 11 and

overturning in 2 days the obviously ill-advised decision not to apply the insider trading rules to investors in order to raise the valuation of the companies listed in the Istanbul Stock Exchange, negatively affect foreign investors decisions.

Foreign investors do not want unfair competition from the government. As an example, I do not know which foreign investor would invest in the retail/supermarket sector in Turkey. You will invest billions of dollars to Migros or a similar chain, after making long and detailed work, calculations and assumptions, but will find yourself unfairly competing with wholesale points opened by the government selling, at a loss and times over cheaper than your market price, some of the products you also sell.

Foreign investors want their investments safe. They do not want to get deadlines from the government to sell, at whatever price they can find, an investment and face the risk of losing the investment or its value if the deadline is missed.

Due to reasons discussed above and some others, foreign investors are reluctant to invest in Turkey now. The share of foreign investors in the government bond market has come down to 5.5%. This is an all time low. Since the beginning of 2020 there has been more than \$8 billion of sales by foreign corporate investors from the government bond and the stock markets. The settlement ratio of foreign investors was 64% last year, it is now 56%. It is of course possible to turn this around, but I am afraid decisions taken because of Covid-19 are delaying the timing of such a turn around.

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